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FM AMEMBASSY ISLAMABAD
TO RUEHC/SECSTATE WASHDC 7518
INFO RHEFDIA/DIA WASHINGTON DC
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RHEFHOT/HOTR WASHINGTON DC//USDAO ISLAMABAD PK//
RUWSMXI/AMC INTEL CEN SCOTT AFB IL//INO/J2-J//
RUEPVAA/CDR JSOC FT BRAGG NC//J2/HSE//
RHMFISS/CDR USCENTCOM MACDILL AFB FL//CCJ2-JCH/HSE//
RHLFABN/CDR USESUCOM ABNCP VAIHINGEN GE//ECJ2/ECJ3/ECJ5-A//
RHMFISS/CDR USSOCOM MACDILL AFB FL//SOJ2/HSE//
RHMFIUU/CDR USTRANSCOM TCJ2 SCOTT AFB IL
RHMFISS/CDRUSAREUR HEIDELBERG GE//AEAGB-IAD//
RUEAIIA/CIA WASHINGTON DC//DDI/OEA//
RUEPVAA/COMJSOC FT BRAGG NC
RHMFIUU/COMSOCCENT MACDILL AFB FL//SOCJ2/HSE//
RHEFDIA/DIA WASHINGTON DC//DHO-3//
RHEFDIA/DIA WASHINGTON DC//MIO-4//
RUETIAA/DIRNSA FT GEORGE G MEADE MD//M112/S2132HT//
RUFOADA/JAC MOLESWORTH RAF MOLESWORTH UK
RUEKJCS/JOINT STAFF WASHINGTON DC//J2/J5-EUR//
RUZFNAI/NASIC WRIGHT PATTERSON AFB OH
RUZFNAI/NASIC WRIGHT PATTERSON AFB OH//DEKA/FCTP//
RUZFNAI/NASIC WRIGHT PATTERSON AFB OH//DXOA/TAAO//
RHEFNGB/NGIC INTEL OPS CHARLOTTESVILLE VA
RHEFNGB/NGIC INTEL OPS CHARLOTTESVILLE VA//IANG-CE-CM/IANG-GS-AA//
RHEFNGB/NGIC INTEL OPS CHARLOTTESVILLE VA//IANG/CE/CECM//
RUCXONI/ONI WASHINGTON DC//32/211//
RUEALGX/SAF WASHINGTON DC
RUEKJCS/SECDEF WASHINGTON DC//USDP-ISA-ADMIN//
RULWAAM/STRATCOM IDHS-90 OFFUTT AFB NE//J22123//
RUEPGAA/US SURVEY DIV SHAPE BE
RUMICEA/USCENTCOM INTEL CEN MACDILL AFB FL
RUEHIL/USDAO ISLAMABAD PK
RUCQSAB/USSOCOM INTEL MACDILL AFB FL
RUEHLO/AMEMBASSY LONDON 2497
RUEHNE/AMEMBASSY NEW DELHI 6147
RUEHBUL/AMEMBASSY KABUL 1533
RUEHLH/AMCONSUL LAHORE 8567
RUEHKP/AMCONSUL KARACHI 2958
RUEHPW/AMCONSUL PESHAWAR 7623
RUEHRC/DEPT OF AGRICULTURE WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RUCPDO/DEPT OF COMMERCE WASHDC
RHEBAAA/DEPT OF ENERGY WASHDC

UNCLAS SECTION 01 OF 04 ISLAMABAD 000437

SENSITIVE
SIPDIS

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SUBJ: BI-WEEKLY REPORT ON ECONOMIC ISSUES, FEBRUARY 17, 2010

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TOP STORIES
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11. (SBU) Government releases \$42 million to cash-strapped Pakistan State Oil (PSO). On February 15, Business Recorder reported that the government had disbursed the funds in order to support the company, which is "on the verge of collapse" because of extensive debt. According to the article, PSO management was unhappy with what they considered a "meager sum" as they were expecting to receive over \$141 million from the Ministry of Finance. PSO representatives fear they will be unable to continue servicing the power sector without an immediate injection of additional funds into the company. Pakistan State Oil currently owes over \$1 billion to local oil refineries.

(Comment: This is not first, and almost certainly not the last time, that PSO has had to press the Ministry of Finance to release

funds. Until the circular debt issue is fully resolved and the energy sector reformed, PSO will continue to have to scrounge to meet its payment obligations as it waits on payments from Pakistan's power companies. End Comment.)

12. (SBU) IMF sets a 5.1 percent budget deficit target for fiscal year 2009-10. On February 17, The News reported that the IMF agreed to increase Pakistan's budget deficit target from 4.9 percent to 5.1 percent. As part of this initiative both parties agreed that the GOP would neither increase nor implement any new taxes. In addition, the IMF decreased the tax revenue target from \$16.42 billion to \$16.2. The IMF is expected to release Pakistan's 5th tranche of funds totaling \$1.21 billion some time next month. (Comment: Contacts at the IMF confirmed this change in the budget deficit target. Even with the more liberal budget deficit target, the GOP will have a hard time meeting the IMF requirement, primarily due to increased military spending and debt servicing. End Comment.)

13. (SBU) Inflation increases to 13.6 percent. On February 11 The News reported that inflation had increased by 3.16 percent compared to December 2009. According to the director of the Top Lines Securities (TLS) brokerage firm, this rise in inflation is attributed to recent hikes in power tariffs, and increases in commodity prices. (Comment: The State Bank Pakistan had already predicted that the GOP would miss the IMF's 9 percent inflation target. End Comment.)

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14. (SBU) Limited rainfall in Sindh likely to spoil wheat crop. On February 7, Business Day reported that Sindh's lower agricultural belt, which includes Sanghar, Hyderabad, Mirpurkhas and Nawabshah, is facing a serious dry spell. Water levels in Sindh are at the lowest point of the last decade. According to officials at the Water and Power Development Authority (WAPDA), the flow of water from the canals is 20 percent less than the average for this season. (Comment: While water flows from the canals remain relatively low nationwide, recent rains have helped to dampen concerns regarding the prospects of the 2010 wheat crop. End Comment.)

15. (SBU) GOP proposes capital gains tax (CGT). Business Recorder reported on February 13 that the government had invited stakeholders to provide their input on the imposition of a capital gains tax (CGT). Representatives from the Karachi Stock Exchange (KSE) suggested that the GOP implement the tax gradually, starting with a 5 percent CGT this fiscal year with an incremental increase to 10 percent by fiscal year 2014-2015. KSE also said that the CGT should only be applicable to short-term capital gains on holdings of less than six months. (Comment: The KSE is proposing an incremental increase in the CGT to ensure that portfolio investment inflows and investment activities are not disrupted. End Comment.)

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STOCK EXCHANGE
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16. (SBU) The Karachi Stock Exchange (KSE)-100 Index ended the week of February 12 at 9,813.08, up 0.44 percent over the previous week's close. Overall market capitalization increased slightly from \$33.09 billion to \$33.25 billion. The week initially opened on a tentative note as the bomb blast in Karachi the previous Friday kept investors hesitant. Foreign portfolio investment, which has been relatively muted for the last few weeks, gathered some steam towards the end of the week with a net foreign portfolio investment inflow of \$3.62 million. (Comment: Contacts at KSE and local brokerage houses said the past week saw a roller coaster ride in the KSE index, which is highly susceptible to both economic and political developments in the country. According to these contacts, the inflation rate, which was released last week, dampened investors' mood as it was higher than expected. End Comment.)

17. (SBU) Lahore Stock Exchange (LSE). The LSE continues to hover

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just over the 3,000 mark. The index climbed 2.1 percent in the first half of February, recovering from a modest decline in late January. Market capitalization was up a strong 2.83 percent.

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POWER & WATER
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18. (SBU) Shell Petroleum decides to remove itself from the Pakistani LPG business after 44 years of operation. On February 12, The News reported that Shell made the decision as a result of the 73.8 percent decline in Shell Gas Pakistan's profits from October through December 2009 compared to the same period in 2008. Shell Petroleum Company Limited is currently seeking potential investors to purchase 67.91 percent of its LPG shareholdings in Pakistan. Comment: In recent months at least two major energy sector companies have expressed interest in divesting from Pakistan; AES and Shell. End Comment.)

19. (SBU) The Government of NWFP building six small dams in Nowshera. On February 14 Business Recorder reported that the total project cost will be \$18 million. The dams would be used to irrigate 14,633 acres of agricultural land and 4 percent of the water will be used to supply drinking water for local residents. Construction on the dams is wrapping up and all six are projected to become operational by June 2010.

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TRANSPORTATION & SHIPPING
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110. (SBU) Advance scanner system installed at city's port. On February 10, Daily Times reported that the GOP had recently installed the Rapiscan Eagle Gantry scanner system at Karachi Port. This scanner will enable port authorities to detect smuggled weaponry and drugs, and is capable of rapid, automated scanning of containers, cargoes and vehicles.

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AGRICULTURE
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111. (SBU) Government decides to monitor sugar mills' production. On February 13 Business Recorder reported that the Ministry of

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Industries has instructed the provincial governments to depute officials to all local sugar mills to monitor their daily production. Representatives from the Pakistan Sugar Mills Association (PSMA) were in an uproar over the decision and have deemed the measure as "an anti-business move." The GOP's decision is attributed to the ongoing shortage of sugar on the local markets and the government's desire to ensure that millers are reporting their production numbers accurately. In early January, the GOP had given the green light to the private sector to import sugar duty free. In spite of these tax breaks, the private sector has imported no sugar to date. According to a February 17 article in Business Recorder, private sector representatives have no incentive to import sugar into the country because of the price disparity between the prevailing local price of sugar and the costs of importing sugar. (Comment: The GOP is hoping that this latest initiative will help discourage the hoarding and the smuggling of sugar into neighboring countries; however, all of these problems result from the GOP's policy of maintaining sugar prices artificially low compared to international market prices. The GOP will continue to face similar issues until it decides to finally let market forces set the price of local commodities. End Comment.)

112. (SBU) The establishment of industrial zones in Bostan, Balochistan, may damage agricultural tube wells. On February 3, Daily Jang Quetta reported that local populations from Bostan met with the acting speaker Balochistan Assembly and the Senior Provincial Minister regarding concerns over the proposed establishment of an industrial zone in Bostan. They argued that Bostan is an agricultural area, and the establishment of an

industrial zone in the area will damage the water table. (Comment: Contacts in Bostan said that the declining underground water level, the main source of water in the area, is the key concern of people. They added that agriculture in the area had suffered in recent years given that a large number of tube wells had gone dry while the remaining tube wells have to go deeper every year. The establishment of industries in the area will require a large amount of water, which would compete with the scarce water available for agricultural purposes. End Comment.)

PATTERSON